COMMONWEALTH OF VIRGINIA, ex rel.

STATE CORPORATION COMMISSION

v. **CASE NO. PUE 980628**

AUBON WATER COMPANY,
Defendant

SETTLEMENT PROGRESS REPORT

May 1, 2000

HISTORY OF THE CASE

On December 16, 1998, the Commission entered an Order of Settlement against Aubon Water Company ("Aubon"). The Order required Aubon to comply with the following timetable and take the following actions to install and operate a water treatment facility to serve the Long Island Estates subdivision located on Smith Mountain Lake in Franklin County, Virginia: (1) submit a Preliminary Engineering Report and cost estimate for the facility to the Commission and the Virginia Department of Health, Office of Water Programs ("VDH-OWP") on or before February 1, 1999; (2) submit a comprehensive business plan detailing the technical, managerial and financial commitments to be made by Aubon to the Commission and VDH-OWP on or before February 1, 1999; (3) submit a set of Final Plans and Specifications and project cost estimates for the installation and operation of the facility to the Commission and VDH-OWP on or before April 15, 1999; (4) submit a written estimate of operation and maintenance expenses associated with the facility, including the contracted expense for a licensed water operator, to the Commission and VDH-OWP on or before April 15, 1999; and complete construction and installation of the facility on or before June 14, 1999. The Order provided that the Commission would retain jurisdiction of the matter until further order of the Commission.

On January 29, 1999, Aubon's consulting engineers, Spectrum Engineers, P.C., submitted its Preliminary Engineering Report for the water treatment facility at Long Island Estates to the VDH-OWP and filed a copy with the Commission. The engineers estimated a total cost of construction for the facility of $71,697.33, and estimated an annual operating expense of $14,523.87. The engineers further estimated a construction timeline that had a completion date for the facility of late September 1999, provided the necessary approvals were obtained from VDH-OWP.

On February 2, 1999, Aubon filed a request for an extension of the timetable established in the Commission's Order of Settlement. Aubon advised the Commission that it had complied with the requirement in paragraph 4(a) of the Order of Settlement that it file a preliminary engineering report and cost estimate for the facility by January 30, 1999. With respect to paragraph 4(b), the requirement that it file a comprehensive business plan detailing the technical, managerial and

financial commitments to be made by the company, Aubon advised the Commission that it met with a representative of the Southeast Rural Community Assistance Project ("SRCAP") to seek assistance with the preparation of the business plan. Aubon further advised the Commission that on January 29, 1999, it applied for a $70,000.00 loan from First Virginia Bank, Rocky Mount, Virginia. It further advised the Commission that the bank requested additional financial information that it could not provide until sometime after February 8, 1999. With respect to paragraph 4(e), the requirement that it complete construction and installation of the facility within 180 days from the date of the Order of Settlement, Aubon requested that the completion date be changed to read "within 60 days of obtaining all permits from Virginia Department of Health." Aubon advised the Commission that discussions between its engineers and the VDH-OWP had shown the original completion date to be unrealistic.

By order entered on February 17, 1999, the Commission assigned this case to a Hearing Examiner to monitor Aubon's compliance with the Commission's Order of Settlement and order such modifications of the timetable established therein as are just and reasonable.

By letter dated March 5, 1999, Aubon's consulting engineers advised the VDH-OWP that they could not complete the design of the water treatment facility without further input from VDH-OWP. Aubon's engineers were at a standstill without that input, and requested an update on the status of the VDH-OWP review of the Preliminary Engineering Report submitted on January 29, 1999.

On March 10, 1999, the Hearing Examiner entered a Ruling scheduling a telephonic hearing for March 19, 1999, for the purpose of hearing argument on Aubon's request to modify the timetable established by the Commission's Order of Settlement.

Aubon's engineers filed a revised construction timeline with the Commission on March 18, 1999. In the engineers' opinion, the new construction timeline would allow a contractor a reasonable period of time to complete the project. The timeline was conditioned on the approval of construction documents by VDH-OWP. The revised timeline provided:

- Advertise for Bids 3 weeks
- Receive Bid and Negotiate Contract 3 weeks
- Order, Fabricate, Receive Equipment, Place Slab, Get Building under Roof, Install Septic Systems, Hook-up Well #4 8 weeks
- Set Tanks, Plumb Building, Tie-in to System 3 weeks
- Electrical, Mechanical, Building Finishes 2 weeks
- Testing, Inspection, Punchlist, Re-inspection 3 weeks

Assuming approval of the construction documents by May 30, 1999, the engineers estimated the project could be operational in 6 months, or by November 30, 1999.

On March 19, 1999, the telephonic hearing was convened as scheduled. Appearing as witnesses at the hearing were: G. Ray Boone, president of Aubon Water Company; Linda Williams Simms, SRCAP; Geoffrey A. Straughn, principal engineer, Spectrum Engineers, P.C.; and Jeremy

D. Hull, district engineer, VDH-OWP, Danville Field Office. The Staff appeared by its counsel Don R. Mueller, Esquire.

At the hearing, Mr. Boone testified that he had met with Ms. Simms concerning obtaining the assistance of SRCAP in developing Aubon's comprehensive business plan. They estimated a completion date of September 30, 1999, for the plan. (Tr. at 13). Mr. Boone further testified that he had applied for a $70,000.00 loan from First Virginia Bank, Rocky Mount, Virginia. The loan had a term of ten years with payments of approximately $1,000.00 per month. Mr. Boone testified he has had a long-term banking relationship with First Virginia Bank. Mr. Boone testified Aubon's current financial statements indicate that the company did not have sufficient cash flow to repay the loan. Mr. Boone advised the bank of Aubon's pending application to increase its rates to fund the water treatment facility. The bank's loan officer indicated to Mr. Boone that the company would have to demonstrate its ability to repay the loan before the bank would loan the company the money to construct the facility. Mr. Boone testified that he did not have sufficient income outside the water company to repay, or guarantee the loan. The Hearing Examiner requested that Mr. Boone obtain a written loan commitment from First Virginia Bank stating the conditions under which the bank was willing to make the loan. (Tr. at 13-21).

Ms. Simms testified that the SRCAP is a non-profit organization that assists small water systems and private individuals with water funding and technical assistance. VDH-OWP has a contract with SRCAP to provide this assistance. Ms. Simms testified that Mr. Boone contacted her on January 27, 1999, requesting assistance with the preparation of a comprehensive business plan. A comprehensive business plan is a document that has been developed by VDH-OWP in response to requirements established by the Environmental Protection Agency (the "EPA") after the Safe Drinking Water Act Amendments of 1996. A comprehensive business plan covers four areas, managerial, operational, technical and financial, and is used to determine if a waterworks has capacity in all four areas to provide safe drinking water. Ms. Simms e-mailed Mr. Boone a copy of a comprehensive business plan, but advised him that other work commitments precluded her from assisting him in the near term. She testified that, if he needed her assistance, he would need at least until September 30, 1999, to complete the plan. Ms. Simms testified the Drinking Water State Revolving Fund Program (the "Revolving Fund") does have monies available to assist small water utilities in installing water treatment facilities; however, it could be two or three years before Aubon makes the list of projects to be funded. (Tr. at 22-32).

Mr. Straughn testified that since VDH-OWP needed additional time to review the preliminary engineering report, it was necessary to slip the schedule for the project. The engineers also needed more time to refine the design based on input from VDH-OWP. Based on that input, the engineers would prepare the final construction documents. Mr. Straughn further testified the water treatment facility his firm designed is based on a green sand filtration system supplied by Culligan. He further testified the estimated $72,000.00 cost for the facility did not include engineering fees. Mr. Straughn estimated the engineering fees to complete the project to be roughly $14,000.00. Mr. Straughn testified the scope of the project had increased with the requirement to abandon Well No. 2 and place Well No. 4 in service.[1] Finally, Mr. Straughn testified his firm's

[1] The iron and manganese content in the water from Well No. 2 is extremely high. The plan is to abandon Well No. 2 and place Well No. 4 into operation in the hope that the water from this well has lower concentrations of iron and manganese. Well No. 4 was installed when the Long Island Estates water system was built, but never placed in service.

contract with Aubon was flexible regarding their level of involvement in the construction process. (Tr. at 33-44).

Mr. Hull testified his office was in the process of reviewing the preliminary engineering report and that review would be completed in another week. Their review of the preliminary engineering report was limited to examining the overall concept of the project. If they were dissatisfied with the approach used to address the water quality problem, they could recommend another course of action. After they submitted their comments to Aubon's engineers, those comments would have to be incorporated into final plans and specifications that would have to be resubmitted to the VDH-OWP for final approval and issuance of a construction permit. The review time for final plans and specifications is usually 45-60 days after submittal. Mr. Hull indicated that his office would attempt to expedite the review process of the final plans and specifications. Mr. Hull testified VDH-OWP sought the Commission's enforcement authority to require Aubon to install the water treatment facility at Long Island Estates. The VDH-OWP had been pursuing Aubon to install a water treatment facility for some time, although they only considered the company's water problem to be aesthetic, rather than a health risk. Mr. Hull also recommended the Revolving Fund as a source of financing for this project. (Tr. at 45-55).

A week after the hearing, Aubon's engineers received VDH-OWP's comments to the preliminary engineering report. Aubon's engineers then requested two exceptions from requirements in VDH-OWP's waterworks regulations. They requested 12 square feet of bench space including sink, instead of the 20 square feet required in the regulation. In addition, they requested elimination of the requirement that the water treatment facility contain a restroom. The engineers requested these exceptions to reduce the cost of the facility. The addition of four linear feet of counter space would increase the requirement for wall and floor space for no other purpose than to allow the operator more room to stand. The addition of a restroom would further increase the size of the facility and require the installation of a septic tank and drainfield. Based on the engineers' review, none of the other 15 iron and manganese treatment facilities in the area had restroom facilities on site. At the hearing, Mr. Hull testified any exceptions to the waterworks regulation must be approved in VDH-OWP's Richmond office. The exceptions were subsequently approved on April 14, 1999.

On April 2, 1999, it was reported in the Franklin News-Post that the Town of Rocky Mount and Franklin County entered into an annexation agreement. The Town would annex approximately 500 acres of Franklin County including the Franklin Heights subdivision. Aubon currently supplies water to the Franklin Heights subdivision pursuant to a Commission issued Certificate of Public Convenience and Necessity. This subdivision represents 142 of the company's 255 customers. The annexation agreement requires the Town to provide water and sewer service to the annexed area within three years from the date of the agreement. After the article was published, Mr. Boone contacted several local government officials, but was unable to get a definitive response on what action the Town was going to take concerning Aubon's Franklin Heights water service territory.

On May 11, 1999, Aubon filed with the Commission a copy of the loan commitment it obtained from First Virginia Bank. The bank agreed to loan Aubon $80,000.00 for a period of ten years at an interest rate of 8.75% per year, with the interest rate fixed for the first three years of the loan. The bank placed two conditions on the loan. First, the Commission must approve the

company's requested rate increase. Second, the Town of Rocky Mount must agree to purchase the Franklin Heights water system for an amount equal to or greater than the amount of the loan, or either agree that Aubon would be the sole supplier of water to Franklin Heights for the ten-year life of the loan. The bank's loan conditions effectively delayed any further progress on the construction of the water treatment facility until these conditions could be satisfied, or until alternative financing could be arranged.

On May 27, 1999, the Staff filed a Motion for Order Directing Defendant to Secure Financing. In its Motion, the Staff argued the loan commitment obtained from First Virginia Bank was unsatisfactory to meet the company's obligations under the Order of Settlement. The Staff requested an order directing Aubon to secure alternative financing including a requirement that Aubon apply to the Revolving Fund to secure financing to complete the project.

Aubon submitted an application to the Revolving Fund prior to the June 15, 1999, deadline for applications for FY 2000 construction funding. The Virginia Department of Health ("VDH") advised Aubon by letter dated July 28, 1999, that it did not make the tentative list of projects. VDH received 44 applications for construction funding and 41 of those applications were eligible for funding. The projects were ranked and the top 15 were funded. Of the projects that were selected, 10 involved public service authorities and 5 involved private water systems. Of the 10 public service authority projects selected, 6 involved contamination of the water source or closing a non-complying water system. The other 4 appear to be public service authority extensions into areas where the homes were previously served by individual water sources. It does not appear from project descriptions that the individual wells in those areas are contaminated or that the water from those wells represents a health hazard. Of the 5 private projects selected, 4 involved contamination of the water source, and the other project involved the abandonment of a private water system for lack of capacity and connection to a public service authority. Aubon ranked 40 out of the 41 projects on the list. VDH encouraged Aubon to apply again next year for FY 2001 construction funding.

During this same period of time, Aubon's engineers continued work on the final plans and specifications for the water treatment facility. The development of those plans was delayed pending the repair of the well casing of Well No. 4, and a drawdown test on the well.[2] Mr. Boone initially indicted that he would perform the drawdown test, but he later contracted with a well drilling company to perform the repairs and the test. On July 9, 1999, the well casing on Well No. 4 was repaired and the well was then tested. A drawdown test requires continuously running the well for 48 hours and taking periodic water samples during the test. In this case, 20 bacteriological water samples were taken and 5 additional water samples were taken to test for metals, volatile organic chemicals and pesticides. The test results indicated that the water quality from Well No. 4 was fairly good with the exception of elevated iron and manganese levels. The color and turbidity of the water was high but this was attributed to the iron and manganese content. Aubon's engineers discussed the test results with VDH-OWP and it was determined the color and turbidity would be removed by the water treatment facility along with the iron and manganese. The yield and drawdown test indicated the well had sufficient capacity to serve the Long Island Estates subdivision.

[2] Sometime after Well No. 4 was installed the casing was damaged. It is unknown when this damage occurred.

By September 17, 1999, all of the major issues involving the final plans and specifications for the water treatment facility had been addressed. However, there were still a few items the engineers requested that Mr. Boone address before the plans and specifications could be submitted for approval. These items included obtaining a survey of the new well lot, and recording the survey in the Franklin County Clerk's Office along with a well dedication document. The engineers also recommended removing a row of trees between the storage tank and Well No. 2, since it was the end of the growing season and the trees could be used for firewood. This would facilitate the site work when construction actually commenced.

On December 17, 1999, the Commission entered a Final Order in Case No. PUE990002. In that order, the Commission approved Aubon's requested rate increase. The primary purpose for the rate increase was to fund the construction of the water treatment facility for Long Island Estates. The Commission's order permitted expenses associated with the facility incurred through the date of the order to be paid out of an escrow account that Aubon would establish to deposit the additional revenue authorized by the Commission for the construction of the facility. Through November 1999, Aubon incurred $17,906.00 in engineering fees on the facility. The repairs to Well No. 4 cost $2,015.00, and the drawdown test and water sampling cost another $3,000.00.

It appeared from documents Aubon provided to the Staff on January 31, 2000, that a number of issues remain unresolved that would further delay the construction of the facility. The final plans and specifications had not been submitted to the VDH-OWP. The well dedication document was filed only that day with the Franklin County Clerk's Office. There was no indication that First Virginia Bank was still interested in financing the project; the bank's loan commitment had expired. Further, the issue involving the annexation of the Franklin Heights subdivision by the Town of Rocky Mount had not been resolved. Mr. Boone reiterated in this correspondence that he could not construct the water treatment facility until he had adequate financing.

On February 7, 2000, the Hearing Examiner entered a Ruling scheduling a hearing for March 7, 2000, in the General District Courtroom, Franklin County Courthouse, Rocky Mount, Virginia. The Hearing Examiner found that a hearing should be conducted in order to gather evidence of the current status of the construction of the water treatment facility, and to facilitate the resolution of any issues that may impede the construction of such facility. The Company and the Staff were directed to submit evidence to address the following outstanding issues:

(1) What is the status of the final engineering plans and specifications for the water treatment facility? When will the final engineering plans and specifications be submitted to VDH-OWP? When will VDH-OWP approve them? What additional information does the VDH-OWP need from Aubon in order to approve the plans and specifications?

(2) What is the status of First Virginia Bank's loan commitment? Have the terms and conditions of the loan commitment changed? If the loan condition relating to the possible annexation of the Company's Franklin Heights water system were resolved in favor of the Company, how long would it take for the bank to make the loan?

(3) What is the status of the Town of Rocky Mount's annexation of Aubon's Franklin Heights water system? Does the Town intend to purchase the Company's water system or build its own water system? Will the Town enter into an agreement that the Company will be the exclusive provider of water to the Franklin Heights subdivision for the ten-year life of the Company's construction loan?

On February 14, 2000, the Staff was advised by Aubon's consulting engineers that the project schedule they previously provided was realistic and achievable once the project is approved by the VDH-OWP. They stated that all of VDH-OWP's comments had been addressed and the Danville Field Office assured them the project would receive the highest priority upon re-submittal. They further stated they had completed the permit application for the addition of Well No. 4 to the system.

On March 7, 2000, the hearing was convened as scheduled. Mr. Greg Abbott, with the Commission's Division of Energy Regulation, testified the final plans and specifications had not been filed with VDH-OWP. He further testified the Staff was disappointed with the progress of the construction of the water treatment facility. In his opinion, Mr. Boone could have taken a more active role in moving the project forward. Mr. Abbott felt that Mr. Boone should have been in a position to move out in short order after the rate case was resolved. Mr. Abbott recommended that a new timetable for this case be established with the requirements set on a date certain. Mr. Abbott entered a water sample he had taken from Long Island Estates into evidence.[3] (Tr. at 82-98).

Mr. Gregory Flory, the new VDH-OWP engineer assigned to this case, testified that he had not received the final plans and specifications for the water treatment facility. He testified that the approval process typically takes about 80 days once the plans and specifications are received. He confirmed that the Revolving Fund ranks projects based on whether there is a health hazard. He did not express an opinion on Aubon's chances of making the list of projects to be funded. He did say it would depend on the other projects that were submitted for that year. He testified the Revolving Fund would begin soliciting applications for FY2001 construction funding on April 15, 2000, and the deadline for applications would be June 15, 2000. He testified his office was not permitted to make recommendations to the Revolving Fund. (Tr. at 100-121).

Mr. Keith Holland, the Town Manager for Rocky Mount, testified a voluntary settlement concerning the annexation was reached between the Town and Franklin County on March 31, 1999. Both political subdivisions adopted an ordinance for annexation on February 28, 2000. The annexation is currently awaiting review by a three-judge panel appointed by the Supreme Court of Virginia. As part of the annexation, the Town is required to provide water service to the Franklin Heights residential area within three years of the effective date of the annexation. The annexation could be effective as early as July 1, 2000. The annexation agreement does not specify how the Town is to provide water service. The Town could satisfy this requirement by contracting with another provider to supply the water. The Town contracted with the engineering firm of Thompson & Litton to conduct a preliminary engineering report and the report indicated that it would be

[3] According to the testimony in this case, the water at Long Island Estates meets all current federal and state health standards for quality. However, but one look, and perhaps one taste, would convince anyone that the water is unfit for human consumption. The water turns brown after it leaves the tap when the high concentrations of iron and manganese oxidize. The water tastes bad, it ruins clothes that are washed in it and it also ruins the plumbing fixtures in the home.

feasible for the Town to supply water to Franklin Heights. The Town has not received its final engineering report. It will base its decision on whether to proceed with the construction of the water system on the report. Mr. Holland expects to receive the final report in May and the town council will probably act on the report in June or July. Mr. Holland indicated he would keep the Commission informed when the final engineering report is received and when the town council takes the matter up on its agenda. (Tr. at 123-137).

Mr. Boone testified that he still has a banking relationship with First Virginia Bank and it is his understanding that if he can demonstrate he has the ability to repay the loan, the bank will loan him the money to construct the water treatment facility. If he were unable to serve Franklin Heights, he would not be in a position to repay the loan. Mr. Boone indicated that he would be re-applying to the Revolving Fund this year for construction financing. Mr. Boone has no other sources for financing the construction of the water treatment facility. Mr. Boone is actively looking for someone to purchase his water system. He mentioned he recently supplied information to API (Aquasource). API is a large national water company that has been purchasing small water companies in Virginia.[4] Mr. Boone further testified that he does not have the funds to hire an attorney to defend his Certificate of Public Convenience and Necessity. Before he would be in a position to comply with the Commission's Order of Settlement, Mr. Boone testified that the question of who will be the water supplier to Franklin Heights must be resolved. (Tr. at 140-156).

Several homeowners from Long Island Estates testified at the hearing: Mr. Robert Pedigo, Mr. Philip Aitcheson, Mr. Allan Busch, and Mr. Theodore Babcock. They raised a number of issues including: the possibility of the homeowners raising the money for the water treatment facility and requiring the water company to repay them; alternate sources of financing; the economic loss they have suffered in ruined clothes and the requirement of purchasing large amounts of bottled water; the state, some other political subdivision, or a public service authority taking over the water system; and refunds from the escrow account if customers drop off the system and drill their own wells. (Tr. at 163-186)

On March 22, 2000, Aubon's consulting engineers filed the final plans and specifications for the water treatment facility with VDH-OWP.

By Hearing Examiner's Ruling entered on April 14, 2000, Aubon was directed to provide, within 15 days after a request therefor, any information requested by VDH-OWP necessary to gain approval of the final plans and specifications. Aubon was further directed to take whatever action it deemed necessary to protect its Certificate of Public Convenience and Necessity to provide water service.

[4] One other regional water company has expressed an interest in possibly purchasing Aubon. This company has sufficient assets to install the water treatment facility without obtaining outside financing. This company also has sufficient qualified staff to operate the facility.

DISCUSSION

This case is a prime example of what can happen with a small private water company, such as Aubon, when it is faced with a major capital expenditure to effect required repairs or improvements in its water system. The company is unable to effect the repairs or improvements from internal working capital and it is forced to obtain financing elsewhere. Financing would have to come either from the State's Revolving Fund or a commercial lender. The Revolving Fund is limited to providing construction funds to address public health problems and to ensure compliance with the provisions of the federal Safe Drinking Water Act. The company may or may not qualify for financing from the Revolving Fund. In order to obtain financing from a commercial lender, the company must demonstrate that it has the ability to repay the loan, which it is unable to do because of insufficient cash flow. For water companies subject to Commission regulation, the Commission is often placed in the position of having to approve a rate increase in order for the company to obtain financing. During this process, which may take some time, the company's customers still suffer with substandard water service. If there is an impediment to obtaining financing, as has occurred in this case, the company's customers are no better off after the Commission's action than they were before the process started. At this point, the only other options available to resolve the company's service problems would be to find a buyer willing to purchase the company and invest the capital to make the repairs or improvements, or have a public service authority take over the operations of the small private water company.

To address the endemic problem of under-capitalized water companies operating in Virginia, the Commission should consider directing the Staff to evaluate the concept of requiring a small water company to maintain a capital account, or meet a minimum net worth requirement in order to operate in Virginia. With a capital account, perhaps a system similar to that of electric cooperatives would be appropriate. Small water companies would be required to maintain an amount equal to $250.00, or some other amount the Commission deems reasonable, times the number of customers served by the water company. In Aubon's case, the capital account would have amounted to $63,750.00, which could have been used as collateral to secure the loan from First Virginia Bank. The Commission could ensure that appropriate safeguards are placed into effect to prevent the water company operator from misappropriating the funds in the account. The Commission could further require that capital account funds be held in a separate interest bearing account segregated from other operating funds. For new customers connecting to the system, their capital account contribution could be included in their connection charge. For customers already on the system, they could have a semiannual surcharge until their capital account is funded. When a customer is no longer served by the water company they could receive a refund of their capital contribution plus accrued interest at some amount fixed by the Commission. Unless the Commission takes a pro-active step to address the problem of these companies operating in Virginia, we will continue to face cases similar to Aubon's in the future. The interests of consumers would be best protected if small water companies were required to meet minimum financial standards in order to operate. Unfortunately, when one of these companies has a problem the only ones who suffer are the company's customers.

Some of Aubon's problems are its own fault for not recognizing its service problems and taking voluntary measures to correct those problems, but some may be traced to the way water companies are regulated in Virginia. Under Virginia's regulatory scheme, the State Board of Health (the "Board") has primary regulatory jurisdiction over water quality and quantity for all public waterworks with 15 or more connections. The Commission has primary regulatory jurisdiction over the rates and terms of service for all public service companies (water utilities) that are designed to serve 50 or more residential building lots. Under its jurisdiction, the Commission may also determine whether public service companies are providing reasonably adequate services and facilities. In this case, the VDH-OWP informally sought Commission intervention in a water quality case that it should have resolved.[5] Aubon's water tastes terrible, it ruins clothes that are washed in it, and it ruins the plumbing fixtures in residents' homes, but the testimony in this case states that consuming the water is not a health risk. The witnesses from the VDH-OWP have repeatedly stated that the elevated iron and manganese levels in Aubon's water are aesthetic problems only and VDH-OWP does not regulate aesthetic standards as part of their regulation of water quality. (Tr. at 54, 106-7). Section 32.1-169 of the Code of Virginia provides:

> The Board shall have general supervision and control over ***all water supplies and waterworks in the Commonwealth insofar as the bacteriological, chemical, radiological and physical quality of waters furnished for drinking or domestic use may affect the public health and welfare and may require that all water supplies be pure water.*** In exercising such supervision and control, the Board shall recognize the relationship between an owner's financial, technical, managerial, and operational capabilities and his capacity to comply with state and federal drinking water standards. (Emphasis added).

"Pure water" is defined in the Code as "water ***fit for human consumption and domestic use*** (i) which is sanitary and normally free of minerals, organic substances and toxic agents in excess of reasonable amounts and (ii) which is adequate in quantity and quality for the minimum health requirements of the persons served." § 32.1-167(5) of the Code of Virginia. (Emphasis added). The Code further defines "domestic use" as "normal family or household use, including drinking, laundering, bathing, cooking, heating, cleaning and flushing toilets." § 32.1-167(2) of the Code of Virginia. The Code further defines a "waterworks" subject to regulation by the Board as "a system that serves piped water for drinking or domestic use to (i) the public, (ii) at least fifteen connections or (iii) an average of twenty-five individuals for at least sixty days out of the year." § 32.1-167(8) of the Code of Virginia. Aubon meets these requirements and is regulated by the Board.

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[5] A better approach to this case would have been for the Board, pursuant to its statutory jurisdiction, to have entered an order requiring Aubon to install a water treatment facility at Long Island Estates. Aubon would then have had to file an application for a rate increase with the Commission to fund the water treatment facility. Based on the Board's order, the Commission would then have ordered the necessary rate increase to fund the construction of the water treatment facility. VDH-OWP would then be responsible for ensuring that Aubon built the water treatment facility and complied with the Board's order. This approach recognizes the benefits of each agency's regulatory jurisdiction. But for the fact the Staff and the VDH-OWP were able to cajole Aubon, who was not represented by an attorney, into agreeing to a Commission Order of Settlement, Aubon was under no legal obligation to install the water treatment facility. If one accepts the argument forwarded by the VDH-OWP that aesthetics are not regulated as part of water quality, Aubon could have relied on that argument and stated that its water meets all current state and federal standards for water quality. Therefore, it is providing reasonably adequate service and it is under no obligation under the law to install a water treatment facility.

The Board is authorized by statute to adopt regulations governing waterworks, water supplies, and pure water. The regulations "shall be designed to protect the public health and promote the public welfare and shall include criteria and procedures to accomplish these purposes. The regulations may include, without limitation . . . [m]inimum health and aesthetic standards for pure water . . . and such other provisions as may be necessary to guarantee a supply of pure water." § 32.1-170 of the Code of Virginia. The Code defines "aesthetic standards" as "water quality standards which involve those physical, biological and chemical properties of water that adversely affect the palatability and consumer acceptability of water through taste, odor, appearance or chemical reaction." § 32.1-167(1) of the Code of Virginia.

One of the stated purposes of the Waterworks Regulation (the "Regulation") adopted by the Board is to "[e]nsure that all water supplies destined for public consumption be pure water." (12 VAC 5-590-30). It further states that "[t]he objectives of a waterworks are: (1) [t]he production of pure water; and (2) [t]he production of water appealing to the consumer." (12 VAC 5-590-650). The Regulation requires all waterworks to "provide adequate treatment and pure water." (12 VAC 5-590-490). Noticeably absent from the Regulation is any reference to an aesthetic standard for water. The Regulation does not even contain the definition of "aesthetic standard" found in the Code of Virginia, cited above. This omission may lead one to believe that the Board may have purposefully determined not to regulate the aesthetics of drinking water in Virginia, although the General Assembly clearly anticipated that the Board would undertake such regulation.[6] Notwithstanding the omission, Aubon's water still does not meet the standard adopted by the General Assembly for "pure water." Aubon's water is not "fit for human consumption and domestic use." Aubon's water does not meet the second part of the pure water standard, that it also be fit for domestic use. The requirement is in the conjunctive. Pure water must be fit for both human consumption ***and*** fit for domestic use. Aubon fails the second part of the test.[7] The high concentrations of iron and manganese stain clothes washed in the water. This makes the water unfit for one of the domestic purposes, laundering. Therein lies the problem. Aubon's water is bad enough to fail to meet the state standard for "pure water," but is apparently not bad enough to qualify for construction financing under the Revolving Fund.

The guidelines for the Virginia Revolving Fund state "[c]onstruction funds for waterworks are to be utilized to address public health problems and to ensure compliance with the [Safe Drinking Water Act]." (Virginia's Drinking Water State Revolving Fund Program, Intended Use Plan for FY 2000, Document Control Number 0003200115 (September 3, 1999)). The federal Safe Drinking Water Act (42 U.S.C. §§ 300f through 300j-26) has established standards for safe drinking water. Those standards may be found in the National Primary Drinking Water Regulations (40 C.F.R. §§ 141.1 through 142.313) and the National Secondary Drinking Water Regulations (40 C.F.R. §§ 143.1 through 143.5). The National Primary Drinking Water Regulations address contaminants in water that may have an adverse effect on a person's health, which includes contaminants such as coliform bacteria and other inorganic contaminants. The National Secondary

[6] The General Assembly could easily rectify this oversight by amending § 32.1-170 of the Code of Virginia and replacing the "may" in the second sentence with a "shall." If the General Assembly did not intend the Board to undertake such regulation, there would have been no reason for the General Assembly to include an "aesthetic standard" in the Code of Virginia.

[7] Aubon's water also fails the objective stated by the Board that waterworks supply water that is "appealing." Aubon's customers would be in unanimous agreement that there is nothing "appealing" in the water supplied by Aubon.

Drinking Water Regulations (the "NSDW Regulations") specify the maximum contaminant levels in public water systems that may adversely affect the odor or appearance of water provided by a public water system that may cause a substantial number of customers to discontinue its use. The NSDW Regulations are intended to protect the public welfare.

According to the testimony in this proceeding, there are no standards governing iron and manganese concentrations for public water systems, and there is no evidence that high concentrations of iron and manganese are harmful to one's health. (Tr. at 54, 106-7). However, the NSDW Regulations have standards for iron and manganese concentrations, as well as other metals and chemicals. The standard for iron is 0.3 mg/l and 0.05 mg/l for manganese. The regulation states these levels represent reasonable goals for drinking water quality. A water test done on Aubon in July 27, 1998 indicated concentrations of iron of 7.39 mg/l and manganese of 1.04 mg/l, almost 20-25 times higher than the federal standard. The States may establish higher or lower levels that may be appropriate depending on local conditions and the availability of other source water. The NSDW Regulations are not federally enforceable, but are intended as guidelines for the States. The NSDW regulations do state, however, that "[a]t considerably higher concentrations of these contaminants, health implications may also exist as well as aesthetic degradation." (40 C.F.R. § 143.1).

The Environmental Protection Agency (the "EPA") is responsible for the administration and primary funding of the Drinking Water State Revolving Fund Program. (40 C.F.R. §§ 35.3100 through 35.3165). In order to receive federal funds, a State must establish a program that complies with federal standards. Once the program is established, EPA provides the State with federal grant funds. For Virginia, the FY 2000 grant was estimated to be $15,231,900.00. Under the program, a State is required to provide a 20% match for the federal funds. Eligible projects include: (1) compliance and public health; (2) loan assistance to systems that meet the definition of a public water system; (3) land acquisition; (4) planning and design of a drinking water project; and (5) restructuring of systems that are in noncompliance or lack the technical, managerial and financial capability to maintain the system. Ineligible projects include: (1) lack of technical, managerial and financial capability; (2) significant noncompliance; and (3) growth. (Environmental Protection Agency, Drinking Water State Revolving Program Guidelines, EPA 816-R-97-005, February 1997).

In reviewing the projects that were funded under Virginia's Revolving Fund for FY 2000, the vast majority of them are clearly related to solving an immediate health concern. However, there are four projects that involve public service authority extensions into areas that were served by individual water sources. Presumably, the individuals in these areas have wells. Unless those wells were contaminated, it would appear that those projects would not meet the criteria set forth above. The project summaries merely state that those areas have an inadequate quantity and quality of individual water supplies. This record does not address whether those projects should have been ranked above Aubon's request for construction funds. In order to improve Aubon's chances for construction funds under the Revolving Fund for FY 2001, Aubon should make it absolutely clear when it reapplies that it is requesting the funds in order to comply with the federal Safe Drinking Water Act's, National Secondary Drinking Water Regulations and the Virginia Waterworks Regulation requirement that it supply "appealing pure water" to its customers. Under the Revolving Fund's scoring criteria, compliance with the federal Safe Drinking Water Act and Virginia's

Waterworks Regulation garner the most points and would improve Aubon's chances of making the construction funding cut.

There are other forces at work that are impacting the construction of the water treatment facility. The Town of Rocky Mount's announced annexation of the Franklin Heights subdivision caused First Virginia Bank to include the second condition in its loan commitment to Aubon. Unless Aubon can obtain alternative financing, the Town will control the outcome of this case. The Town's consulting engineers are preparing their final recommendations for providing municipal water service to Franklin Heights. The engineers have already found in their preliminary engineering report that it would be feasible for the Town to provide water service to Franklin Heights. The engineers will not have their final recommendations to the Town until June or July 2000.

The Town may take any one of a number of courses of action. First, the Town may contract with Aubon to continue providing water to Franklin Heights. In this case, Aubon would qualify for the loan from First Virginia Bank. The Town may do this and still meet its obligation under the annexation agreement to provide water and sewer services to the area it annexed. The question is whether the Town would do this. If the Town has to tear up the streets to install sewer service to this area, it would only make sense from an engineering perspective to install the water lines at the same time. Second, the Town may attempt to condemn Aubon's Franklin Heights water system. The Commission would hear the condemnation case pursuant to § 25-233 of the Code of Virginia. This statute provides:

> [n]o corporation or authority created under the provisions of Chapter 54 (§ 15.2-5400 *et seq*.) of Title 15.2 shall file a petition to take by condemnation proceedings any property belonging to any other corporation possessing the power of eminent domain, unless, after notice to all parties in interest and an opportunity for a hearing, the State Corporation Commission shall certify that a public necessity or that an essential public convenience shall so require, and shall give its permission thereto; and in no event shall one corporation take by condemnation proceedings any property owned by and essential to the purposes of another corporation possessing the power of eminent domain. If the State Corporation Commission gives its permission to a condemnation, the Commission shall establish for use in any condemnation proceeding whether any payment for stranded investment is appropriate and, if so, the amount of such payment and any conditions thereof.

In order to qualify for the loan from First Virginia Bank, Aubon must receive at least $80,000.00 from any condemnation proceeding. If Aubon did receive this amount, there would really be no need to obtain financing from the bank. Aubon could finance the water treatment facility project from the proceeds of the condemnation. Finally, the Town may attempt to install its own parallel system in Franklin Heights. A Commission issued Certificate of Public Convenience and Necessity is a property right. *Town of Culpepper* v. *VEPCO*, 215 Va. 189, 194, 207 S.E.2d 864, 868 (1974). As such, the Town's action of installing a parallel water system may constitute a "taking" of Aubon's property right. Aubon has indicated that it does not have the financial resources to engage in litigation with the Town to defend its Certificate of Public Convenience and Necessity.

If the Town chooses the first option, Aubon may have insufficient time to secure financing before the Commission's Final Order in Case No. PUE990002 requires the Company to rollback its rates. If it has not secured financing by August 17, 2000, the order requires Aubon to rollback its rates on that date and refund the money in the escrow account to its customers. Since the Town is not planning to act on its engineers' recommendations until June or July, I recommend the Commission extend the date to secure financing to December 31, 2000.

Extending the date in the Commission's Final Order in Case No. PUE990002 has additional benefits. At present, there are two large private water companies evaluating the possible purchase of Aubon. Both of these companies have the capacity to install the water treatment facility without securing outside financing. In addition, these companies have sufficient resources to defend Aubon's Certificate of Public Convenience and Necessity to provide water service. These companies expressed some concern that if the sale of Aubon was not consummated prior to August 17, 2000, the purchaser would be faced with the expense of having to file for another rate increase. Extending the August 17th deadline to December 31, 2000, allows Aubon and the Staff additional time to work with any potential purchaser to effect the sale of the company.

I am still confident that water service problems at Long Island Estates can be resolved. For the Commission, the most important thing that can be done to keep the process moving is to provide the parties additional time to see which of the three alternative courses of action the Town will choose, and to see whether Aubon can be sold to another water company. I further recommend that the Commission direct that I continue to monitor Aubon's compliance with the Commission's Order of Settlement.

FINDINGS AND RECOMMENDATIONS

Based on the record developed in this case, I recommend the Commission take the following actions:

(1) Direct the Staff to evaluate the concept of requiring a small water company to maintain a capital account to address unexpected repairs and improvements to its water system, or meet a minimum net worth requirement in order to operate in Virginia;

(2) Extend the date in its Final Order in Case No. PUE990002 by which Aubon must secure financing for construction of the water treatment facility to December 31, 2000; and

(3) Direct this Hearing Examiner to continue to monitor Aubon's compliance with the Commission's Order of Settlement in case No. PUE980628.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Settlement Progress Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within fifteen (15) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

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Michael D. Thomas
Hearing Examiner